Depreciation and Amortization Expense

Depreciation and amortization expense increased to $78.4 million for 1996 from $37.8 million for 1995, an increase of $40.6 million, or 107%. This increase is primarily attributable to increased depreciation associated with the expansion of the local telecommunications networks throughout the country and increased amortization of goodwill related to various 1996 acquisitions. On a pro forma basis, depreciation and amortization expense, which included depreciation and amortization of the Local Market Partnerships, increased to $96.3 million for 1996 from $62.8 million for 1995, an increase of $33.5 million, or 53%.

Interest Income

Interest income increased to $30.2 million for 1996 from $4.1 million for 1995, an increase of $26.1 million. This increase is attributable to interest earned on the cash and cash equivalents and marketable securities that resulted from the proceeds of the 1996 Offerings.

Interest Expense

Interest expense increased to $73.6 million for 1996 from $23.3 million for 1995, an increase of $50.3 million. This increase resulted from interest on the Company's Senior Notes, Senior Discount Notes, and the TCI Subordinated Note, offset by the absence of approximately six months of interest associated with the Revolving Credit Agreement and borrowings under a loan agreement from the Cable Stockholders for the year ended December 31, 1996.

Equity in Losses of Unconsolidated Affiliates

Equity in losses of unconsolidated affiliates decreased to $19.4 million for 1996 from $19.5 million for 1995, a decrease of $0.1 million. This decrease resulted from the consolidation of the Local Market Partnerships in June 1996, offset by greater losses in 1996 versus 1995.

Income Taxes

In 1996 and 1995, TCG generated net operating losses and, accordingly, incurred a net tax benefit. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," such tax benefit was fully offset, each year, by a valuation allowance. Both the 1996 and 1995 provisions for income taxes resulted from state income taxes where TCG is required to file separate state income tax returns.

At December 31, 1996, TCG had operating loss carry-forwards for tax purposes of approximately $170.5 million, expiring principally in 2009 through 2012.

Net Loss

The Company's results for 1996 reflected a net loss of $114.9 million, compared to a net loss of $53.8 million for 1995, an increase of $61.1 million. This increase in net loss is attributable to the factors discussed above. On a pro forma basis, net loss increased to $126.6 million for 1996 from $67.6 million for 1995, an increase of $59.0 million.

Liquidity and Capital Resources

As of December 31, 1997, TCG had total assets of approximately $2.5 billion, an increase of approximately $400.0 million from $2.1 billion as of December 31, 1996. The Company's current assets of $600.2 million as of December 31, 1997, exceeded current liabilities of $375.3 million, providing working capital of $224.9 million. Network and equipment, net of depreciation as of December 31, 1997, aggregated approximately $1.5 billion.

Net cash provided by financing activities for the years ended December 31, 1997 and 1996 was $258.6 million and $1.1 billion, respectively. Cash flows from financing activities for 1997 consisted primarily of for 1996 from $184.9 million for 1995, an increase of $98.5 million, or 53%. This growth in revenues is a direct result of increased market penetration of all telecommunications services offered in existing markets and the addition of new markets. On a pro forma basis, annualized monthly recurring revenue increased to approximately $329.0 million for December 1996 from $211.1 million for December 1995, an increase of $117.9 million, or 56%. Monthly recurring revenue represents monthly service charges billable to telecommunications services customers for the month indicated, but excludes non-recurring revenues for certain one-time services, such as installation fees or equipment charges.

On a pro forma basis, switched services revenue increased to $113.0 million for 1996 from $63.9 million for 1995, an increase of $49.1 million, or 77%. The increase is due primarily to: increases in switched, local and toll services revenue; long distance carrier access usage volumes; and sales of additional enhanced switched services products to customers in existing and new markets. On a pro forma basis, dedicated services revenue increased to $161.7 million for 1996 from $116.5 million, which included $1.7 million in data services products for 1995, an increase of $45.2 million, or 39%.

Management and royalty fees from Local Market Partnerships decreased to $22.8 million for 1996, a decrease of $8.7 million, or 28%, from $31.5 million for 1995. Management fees are directly related to operating and administrative support services provided by TCG to the former Local Market Partnerships. The royalty fees were charged to the Local Market Partnerships based on revenue. As a result of the TCG Reorganization, management and royalty fees from the Local Market Partnerships are no longer reflected as revenue beginning July 1, 1996, due to the consolidation of the Local Market Partnerships.

Operating Expenses

Operating expenses increased to $157.6 million for 1996 from $93.1 million for 1995, an increase of $64.5 million, or 69%. This increase is primarily attributable to costs associated with the expansion of networks throughout the country, including technical personnel costs and access, rights-of-way, node, rent and maintenance expenses. The increase in operating expenses is also attributable to the access and maintenance expenses associated with the growth of switched services in existing markets and the expansion into new markets. On a pro forma basis, operating expenses, which included expenses generated by the Local Market Partnerships, increased to $172.4 million for 1996 from $112.6 million for 1995, an increase of $59.8 million, or 53%.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased to $85.0 million for 1996 from $50.5 million for 1995, an increase of $34.5 million, or 68%. This increase is a result of the continued expansion of network infrastructure to support continued expansion of the Company's networks, including costs associated with servicing the increased number of both dedicated and switched services customers. These costs include expenses related to compensation, occupancy, insurance and professional fees. On a pro forma basis, selling, general and administrative expenses which included expenses generated by the Local Market Partnerships, increased to $98.4 million for 1996 from $71.7 million for 1995, an increase of $26.7 million, or 37%.

EBITDA

EBITDA increased to $25.1 million for 1996 from $22.6 million for 1995, an increase of $2.5 million. This increase is primarily attributable to increases in dedicated and switched revenues. Additionally, on a pro forma basis, TCG has reduced its operating and administrative expenses, as a percentage of revenues, primarily by obtaining lower unit access costs through negotiation of, and participation in, regulatory proceedings relating to various interconnection and reciprocal agreements with ILECs across the country, and by obtaining greater efficiencies through automation. On a pro forma basis, EBITDA increased to $12.6 million for 1996 from $0.6 million for 1995, an increase of $12.0 million. The Local Market Partnerships are included in the pro forma financial data as a result of the TCG Reorganization.

Interest Expense

Interest expense increased to $116.2 million for 1997 from $73.6 million for 1996, an increase of $42.6 million. This increase resulted from interest on the Company's Senior Notes, Senior Discount Notes and the TCI Subordinated Note. The TCI Subordinated Note was repaid on December 31, 1997, at a discounted value of $25.1 million. In 1996, TCG recorded interest on the Revolving Credit Agreement and borrowings under the loan facility with the Cable Stockholders. Pursuant to the TCG Reorganization, TCG no longer had these debts, and therefore, no interest expense was recorded in 1997. Offsetting this decrease is the interest expense recorded on the bank debt which TCG assumed in the acquisition of ETC.

Equity in Losses of Unconsolidated Affiliates

Equity in losses of unconsolidated affiliates decreased to $3.4 million for 1997 from $19.4 million for 1996, or a decrease of $16.0 million. This decrease resulted primarily from the consolidation of the Local Market Partnerships and ETC.

Income Taxes

In 1997 and 1996, TCG generated net operating losses and, accordingly, incurred a net tax benefit. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," such tax benefit was fully offset, each year, by a valuation allowance. Both the 1997 and 1996 provisions for income taxes resulted from state income taxes where TCG is required to file separate state income tax returns.

At December 31, 1997, TCG had operating loss carry-forwards for tax purposes of approximately $523.0 million, expiring principally in 2003 through 2013. Approximately $49.0 million of the net operating loss carryforward relates to the acquisitions of BizTel and ETC.

Net Loss

The Company's results for 1997 reflected a net loss of $222.7 million, compared to a net loss of $114.9 million for 1996, or an increase of $107.8 million. This increase in net loss is attributable to the factors discussed above. Net loss increased to $222.7 million for 1997 from $126.6 million on a pro forma basis for 1996, or an increase of $96.1 million.

Year Ended December 31, 1996 Compared to Year Ended December 31, 1995

Revenues

Total revenues increased to $267.7 million for 1996 from $166.2 million for 1995, representing an increase of $101.5 million, or 61%. Telecommunications services revenue increased to $244.9 million for 1996 from $134.7 million for 1995, an increase of $110.2 million, or 82%. Revenue increased in every category, most significantly in switched services. These increases reflect increased sales of services in existing and new markets and the growth of TCG's customer base.

During 1996, TCG expanded its dedicated services markets to Salt Lake City, Portland (Oregon), Cleveland and Washington D.C. It also expanded its switched services markets to Indianapolis, Denver, and New Jersey and installed a second switch in its Boston metropolitan serving area. TCG significantly increased revenue from the Company's data services line of business in 1996 by $3.0 million, an increase of 290% from 1995.

On a pro forma basis, had telecommunications services revenue generated by unconsolidated Local Market Partnerships been included in the consolidated financial statements of the Company in 1996 and the combined financial statements of TCG and TCG Partners in 1995, total revenues would have increased to $283.4 million for the year ended December 31, 1997. The remaining increases are primarily attributable to costs associated with the expansion of networks throughout the country, including compensation costs for technical personnel, access, bad debt, rent and maintenance expenses. The increase in operating expenses is also attributable to the access and maintenance expenses associated with the growth of switched services in existing markets and the expansion into new markets. Offsetting these expense increases are reductions in expenses due to renegotiation of interconnection agreements with ILECs. Operating expenses increased to $283.4 million for 1997 from $172.4 million on a pro forma basis for 1996, an increase of $111.0 million, or 64%. Operating expenses were approximately 57% and 59% of revenue for the years ended December 31, 1997 and 1996, respectively, and 61% of revenue for the year ended December 31, 1996 on a pro forma basis.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased to $166.0 million for 1997 from $85.0 million for 1996, an increase of $81.0 million, or 95%. Pursuant to the TCG Reorganization, TCG has consolidated the financial statements of the Local Market Partnerships, the selling, general and administrative expenses of which accounted for 23% of the total selling, general and administrative expenses for the year ended December 31, 1997. The remaining increase is a result of the continued expansion of network infrastructure to support continued expansion of the Company's networks, including costs associated with servicing the increased number of dedicated, switched, data and Internet services customers. These costs include expenses related to compensation, including commissions, occupancy, professional fees and various marketing and promotional expenses. Selling, general and administrative expenses increased to $166.0 million for 1997 from $98.4 million, on a pro forma basis, for 1996, an increase of $67.6 million, or 69%. Selling, general and administrative expenses were approximately 34% and 32% of revenue for the year ended December 31, 1997 and 1996, respectively, and 35% of revenue for the year ended December 31, 1996 on a pro forma basis.

EBITDA

TCG recorded a one-time, non-recurring charge of $22 million for certain acquired in-process research and development costs related to the acquisition of CERFnet. For comparison purposes, Recurring EBITDA for 1997 is defined as EBITDA excluding the one-time charge for acquired in-process research and development costs. Recurring EBITDA increased to $44.9 million for 1997 from EBITDA of $25.1 million for 1996, an increase of $19.8 million. The increase in Recurring EBITDA is primarily attributable to increases in dedicated and switched revenues. Recurring EBITDA increased to $44.9 million for 1997 from EBITDA of $12.6 million on a pro forma basis for 1996, an increase of $32.3 million. Comparing 1997 to 1996 on a pro forma basis, TCG has reduced its operating and administrative expenses, as a percentage of revenues, primarily by obtaining lower unit access costs through negotiation of, and participation in, regulatory proceedings relating to various interconnection and reciprocal agreements with ILECs across the country, and by obtaining greater efficiencies through automation.

Depreciation and Amortization Expense

Depreciation and amortization expense increased to $155.4 million for 1997 from $78.4 million for 1996, an increase of $77.0 million, or 98%. This increase is primarily attributable to increased depreciation associated with the expansion of the local telecommunications networks throughout the country and increased amortization of goodwill, FCC licenses and other intangibles related to various 1997 and 1996 acquisitions. Depreciation and amortization expense increased to $155.4 million for 1997 from $96.3 million on a pro forma basis for 1996, an increase of $59.1 million, or 61%.

Interest Income

Interest income increased to $31.1 million for 1997 from $30.2 million for 1996, an increase of $0.9 million. This increase is attributable to an increase in the average outstanding balance of cash and cash equivalents and marketable securities that resulted from the proceeds of the 1996 Offerings and the 1997 Equity Offering.

and TCG San Francisco, respectively, and InterMedia Partners' equity interest of 4.2% in TCG San Francisco. In 1997 TCG no longer recorded minority interest for the Local Market Partnerships due to the completion of the TCG Reorganization.

(5) Pro forma financial information for the year ended December 31, 1996 is as if the TCG Reorganization had occurred at the beginning of the year. Pro forma adjustments include the reversal of TCG's equity in the losses of 13 Local Market Partnerships, as well as amortization of the goodwill which was recorded upon closing of the transactions and the reduction of interest expense from the conversion to equity of subordinated debt owned by TCG to the Cable Stockholders. Such information is presented for a more meaningful comparison between 1997 and 1996.

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

Revenues

Total revenues increased to $494.3 million for 1997 from $267.7 million for 1996, representing an increase of $226.6 million, or 85%. Pursuant to the TCG Reorganization, TCG consolidated the financial statements of the Local Market Partnerships, which accounted for 17% of total revenue for the year ended December 31, 1997. Telecommunications services revenue increased to $494.3 million for 1997 from $244.9 million for 1996, an increase of $249.4 million, or 102%. Revenues increased in every category, most significantly in switched services. These increases reflect increased sales of services in existing and new markets and the growth of TCG's customer base. Had telecommunications services revenue generated by unconsolidated Local Market Partnerships been included in the consolidated financial statements of the Company for all of 1996, total revenues would have increased to $494.3 million for 1997 from $283.4 million for 1996, on a pro forma basis, an increase of $210.9 million, or 74%. This growth in revenues is a direct result of increased market penetration of all telecommunications services offered in existing markets and the addition of new markets. Total revenues for the year ended December 31, 1997, include $48.1 million attributable to (i) ETC and CERFnet, which were acquired by TCG during the first quarter of 1997, and (ii) BizTel, which was acquired by TCG in the last quarter of 1997. TCG consolidated the financial statements of ETC, CERFnet and BizTel from the dates of acquisition.

Annualized monthly recurring revenue increased to approximately $619.9 million for December 1997 from $329.0 million on a pro forma basis for December 1996, an increase of $290.9 million, or 88%. Monthly recurring revenue represents monthly service charges billable to telecommunications services customers for the month indicated, excluding non-recurring revenues for certain one-time services, such as installation fees or equipment charges.

Switched services revenue increased to $215.2 million for 1997 from $113.0 million on a pro forma basis for 1996, an increase of $102.2 million, or 90%. The increase is due primarily to: increases in switched, local and toll services revenue; long distance carrier access usage volumes; and sales of additional enhanced switched services products to customers in existing and new markets. Dedicated services revenue increased to $252.4 million for 1997 from $161.7 million for 1996, on a pro forma basis, an increase of $90.7 million, or 56%. TCG's data and Internet revenues increased to $22.1 million for 1997 from $1.5 million on a pro forma basis for 1996, an increase of $20.6 million.

Management fees were directly related to operating and administrative support services provided by TCG to the Local Market Partnerships. Royalty fees were charged to the Local Market Partnerships based on revenue. As a result of the TCG Reorganization, management and royalty fees from the Local Market Partnerships were no longer reflected as revenue beginning July 1, 1996, due to the consolidation of the Local Market Partnerships.

Operating Expenses

Operating expenses increased to $283.4 million for 1997 from $157.6 million for 1996, an increase of $125.8 million, or 80%. Pursuant to the TCG Reorganization, TCG consolidated the financial statements of the Local Market Partnerships, the operating expenses of which accounted for 17% of the total operating expenses

Results of Operations

The following tables present historical financial information for 1997 and 1996 and unaudited pro forma financial data for 1996, as if the TCG Reorganization had occurred at the beginning of the year. Pro forma adjustments include the reversal of TCG's equity in losses of 13 Local Market Partnerships for 1996, as well as amortization of the goodwill which was recorded upon closing of the transactions and the reduction of interest expense from the conversion to equity of subordinated debt owed by TCG to the Cable Stockholders. Such information is presented for a more meaningful comparison between 1997 and 1996. The unaudited pro forma financial data does not purport to represent what TCG's results of operations or financial condition would actually have been if the transactions that give the rise to the pro forma adjustments had occurred on the date assumed.

	Years Ended December 31,		Pro Forma for the TCG Reorganization (5) Year Ended December 31,
	1997	1996	1996
	(dollars in thousands, except share amounts)		
Statements of Operations Data:			
Revenues:			
Telecommunications service	$ 494,304	$ 244,864	$ 283,383
Management and royalty fees from Local Market Partnerships(1)	—	22,805	—
Total Revenues	494,304	267,669	283,383
Operating expenses	283,440	157,591	172,374
Selling, general and administrative expenses(2)	165,977	85,025	98,436
In-process research and development costs(3)	22,000	—	—
Depreciation and amortization	155,402	78,416	96,260
Operating loss	(132,515)	(53,363)	(83,687)
Interest:			
Interest income	31,111	30,219	29,163
Interest expense	(116,172)	(73,633)	(66,946)
Net Interest expense	(85,061)	(43,414)	(37,783)
Minority interest(4)	—	3,520	4,713
Equity in losses of unconsolidated affiliates	(3,427)	(19,400)	(7,650)
Loss before income taxes	(221,003)	(112,657)	(124,407)
Income tax provision	(1,664)	(2,193)	(2,193)
Net loss	$ (222,667)	$ (114,850)	$ (126,600)
Net loss per share	$ (1.34)	$ (1.00)	$ (0.86)
Weighted average number of shares	165,728,059	114,443,695	146,423,705

(1) Under the terms of various management services arrangements among TCG and its unconsolidated Local Market Partnerships and certain other affiliates, TCG provided operating and administrative support services to such entities, for which it earned management fees. Upon consummation of the TCG Reorganization, these fees were no longer reflected as revenues.

(2) Included in selling, general, and administrative expenses are expenses incurred for services provided to the Local Market Partnerships, in the amount of $21.4 million, for the year 1996.

(3) In December 1997, TCG evaluated the acquired assets and liabilities of CERFnet, and as a result of the evaluation, TCG expensed acquired in-process research and development costs.

(4) Minority interest reflects TCI and Continental affiliates' interests in TCG St. Louis for 1996. In 1996, after giving effect to the TCG Reorganization and the debt and equity offerings consummated in 1996, the minority interest reflects Viacom Telecom, Inc.'s equity interests of 22.2% and 22.9% in TCG Seattle

capital expenditures, TCG begins to incur direct operating costs upon commencement of the installation phase of a network for such items as salaries and office rent. The exact amounts and timing of these expenditures and costs are subject to a variety of factors which may vary greatly by geographic market. As network installation progresses, TCG incurs rights-of-way costs, increased sales and marketing expenses (including sales commissions) and, in certain markets, franchise fees and taxes paid to local governments based on revenue. Although TCG's revenues have increased substantially, TCG's expenses associated with the expansion and development of its local telecommunications networks have exceeded such revenues. TCG expects its net losses to grow as it continues to expand its networks. However, generally, after the network infrastructure is established, TCG can add customers and increase revenues with less additional expense. After a customer is added and the volume of such customer's communications traffic handled by TCG grows, incremental revenues can be added with minimal additional expense, providing significant contributions to EBITDA (earnings (loss) before interest, income taxes, depreciation, amortization, minority interest and equity in losses of unconsolidated affiliates). For 1997, "Recurring EBITDA" is defined as EBITDA excluding a one-time non-recurring charge for acquired in-process research and development costs. See "Year Ended December 31, 1997 Compared to Year Ended December 31, 1996—EBITDA."

As of December 31, 1997, TCG's consolidated financial statements reflect the results of TCG's wholly-owned subsidiaries. The consolidated statements of operations and cash flows include equity in the losses of BizTel for ten months and of ETC for two months. See "Business—Other Recent Developments". On June 1, 1997, TCG entered into a Technical Services Agreement with KCFN whereby TCG assumed managerial oversight of the day-to-day operations of KCFN. TCG has recorded the results of operations from that date.

For the year ended December 31, 1997, TCG's capital expenditures, its acquisitions and working capital were funded by the 1997 Equity Offering, which raised approximately $328.7 million of aggregate gross proceeds and the 1996 Offerings, which raised approximately $1.3 billion of aggregate gross proceeds.

The development of TCG's business, the construction and expansion of its telecommunications networks and its operating expenses require significant expenditures, often resulting in negative cash flow. Although TCG generated positive Recurring EBITDA for 1997, several of its subsidiaries did not and will not generate positive EBITDA until such time as adequate customer bases are established.

Internet service providers, disaster recovery service providers, wireless communications companies and financial services companies. TCG offers these customers technologically advanced telecommunications services, as well as superior customer service, flexible pricing and vendor and route diversity. During 1997 TCG completed the acquisitions of ETC, now known as TCG Delaware Valley, Inc., CERFnet, now known as TCG CERFnet, Inc. and BizTel. TCG expects to complete the acquisitions of ACC Corp. and of Kansas City Fiber Network, L.P. by the end of the second quarter of 1998.

On January 8, 1998, TCG entered into the AT&T Agreement. In the AT&T Merger, each share of TCG Common Stock will be converted into 0.943 of a share of AT&T common stock. The AT&T Agreement contains customary representations and warranties of the parties, which will not survive effectiveness of the AT&T Merger. In addition, the AT&T Agreement contains certain restrictions on the conduct of TCG's business prior to the consummation of the AT&T Merger. Pursuant to the AT&T Agreement, TCG has agreed, for the period prior to the AT&T Merger, to operate its business in the ordinary course, refrain from taking various corporate actions without the consent of AT&T, and not solicit or enter into negotiations or agreements relating to a competing business combination. See "Business—The AT&T Merger".

For over 13 years, TCG has developed, operated and expanded its local telecommunications networks. During the fourth quarter, TCG added eight new markets, which brings total MSAs served by TCG to 65. These 65 MSAs are in metropolitan New York/New Jersey, Los Angeles, Chicago, San Francisco, Philadelphia, Boston, Detroit, Baltimore, Washington, D.C., Dallas, Houston, Miami/Ft. Lauderdale, Seattle, San Diego, St. Louis, Pittsburgh, Phoenix, Denver, Milwaukee, Indianapolis, Hartford, Omaha, Providence, Cleveland, Portland (Oregon), Salt Lake City, Nashville, Chattanooga, Knoxville, Birmingham, Cincinnati, Columbus (Ohio), Charlotte, Tampa Bay, Sacramento, Minneapolis-St. Paul, Atlanta and Orlando, including 19 of the 20 largest metropolitan areas. As of December 31, 1997, the fiber optic networks of the Company's wholly-owned subsidiaries spanned over 9,470 route miles, contained over 491,090 fiber miles and served approximately 13,510 buildings.

On July 2, 1996, TCG issued 27,025,000 shares of TCG Class A Common Stock (the "Stock Offering") which resulted in gross proceeds of approximately $432.4 million as part of an initial public offering, $300 million of 9⅞% Senior Notes due 2006 (the "1996 Senior Notes") and $1,073 million aggregate principal amount at maturity of 11⅛% Senior Discount Notes due 2007 (the "1996 Senior Discount Notes" and, together with the 1996 Senior Notes, the "1996 Notes"). Prior to the 1996 Notes offering and the Stock Offering (collectively, the "1996 Offerings"), TCG was owned by subsidiaries of the Cable Stockholders. The business was operated through TCG and, beginning in 1992, TCG Partners, which is a New York general partnership owned prior to the TCG Reorganization by the Cable Stockholders in the same percentages as TCG. TCG Partners was formed to invest, with TCG, the Cable Stockholders and other cable operators, in 14 Local Market Partnerships to develop and operate local telecommunications networks. The Local Market Partnerships were owned by TCG, and/or TCG Partners, certain of the Cable Stockholders which had cable operations in the particular markets addressed by the Local Market Partnerships and, in some cases, other cable operators in such markets. To simplify this complex ownership structure, the Company and the Cable Stockholders completed the TCG Reorganization whereby, TCG agreed to consolidate the ownership of TCG Partners and of the Local Market Partnerships as wholly-owned subsidiaries of TCG. As part of this process, certain of the other cable operators agreed to sell their interests in the Local Market Partnerships to TCG directly or through a Cable Stockholder. See "Business—The TCG Reorganization". The financial statements for one of the Local Market Partnerships were previously consolidated with those of TCG. Therefore, as a result of the TCG Reorganization, TCG consolidated the financial statements of the remaining 13 of the 14 Local Market Partnerships.

In response to customer demand, the Company plans to increase the geographic reach and density of its existing networks by deploying additional fiber optic rings and connecting additional customers to its networks. The costs associated with the initial installation and expansion of each network, including development, installation, certain organizational costs and early operating expenses, are significant and result in negative cash flow for that market until an adequate customer base and revenue stream have been established. In addition to

	As of December 31,				
	1997	1996	1995	1994	1993
	(dollars in thousands)				
Balance Sheet Data:					
Cash and cash equivalents and marketable securities	$ 480,159	$ 718,346	$ 11,862	$ 26,000	$ 31,716
Working capital	224,889	545,325	(47,083)	(32,719)	(15,278)
Fixed assets—at cost	1,873,083	1,304,229	545,653	422,964	329,686
Total assets	2,456,301	2,050,097	614,793	486,983	365,202
Long-term debt (including capital lease obligations)	1,054,079	1,021,063	368,464	200,462	29,689
Minority interest	—	—	4,409	2,903	12,661
Stockholder's equity and partners' capital (deficit)	1,031,616	796,870	125,348	179,152	209,141

(1) Under the terms of various management services arrangements among TCG and its unconsolidated Local Market Partnerships and certain other affiliates, TCG provided operating and administrative support services to such entities, for which it earned management fees. Upon consummation of the TCG Reorganization, these fees were no longer reflected as revenues.

(2) Included in selling, general, and administrative expenses are expenses incurred for services provided to the Local Market Partnerships, in the amounts of $21.4 million, $29.6 million, $19.4 million and $1.4 million for the years 1996, 1995, 1994 and 1993, respectively.

(3) In December 1997, TCG evaluated the acquired assets and liabilities of CERFnet, and as a result of the evaluation, TCG expensed acquired in-process research and development costs.

(4) Minority interest reflects Fidelity Communications Inc.'s equity interest in Teleport Communications Boston for 1993 and 1994; a Cox affiliate's interest in TCG San Diego for 1993 and 1994; and TCI and Continental affiliates' interests in TCG St. Louis for 1994 and 1995 and 1996. In 1996, after giving effect to the TCG Reorganization and the debt and equity offerings consummated in July 1996, the minority interest reflects Viacom Telecom, Inc.'s equity interests of 22.2% and 22.9% in TCG Seattle and TCG San Francisco, respectively, and InterMedia Partners' equity interest of 4.2% in TCG San Francisco. In 1997 TCG no longer recorded minority interest for the Local Market Partnerships due to the completion of the TCG Reorganization.

(5) EBITDA consists of earnings (loss) before interest, income taxes, depreciation, amortization, minority interest and equity in losses of unconsolidated affiliates. It is a measure commonly used in the telecommunications industry and is presented to assist in understanding TCG's operating results. EBITDA is not intended to represent cash flows or results of operations in accordance with U.S. GAAP for the periods indicated. TCG's use of EBITDA may not be comparable to similarly titled measures due to the use by other companies of different financial statement components in calculating EBITDA. In 1997, this amount represents Recurring EBITDA which is defined as EBITDA excluding a one-time non-recurring charge for acquired in-process research and development costs.

(6) Capital expenditures for 1996 are net of the effect of the inclusion of the Local Market Partnerships as of June 30, 1996.

(7) The ratio of earnings to fixed charges is computed by dividing pre-tax income from operations before fixed charges (other than capitalized interest) by fixed charges. Fixed charges consist of interest charges and the amortization of debt expense and discount or premium related to indebtedness, whether expensed or capitalized, and that portion of rental expense the Company believes to be representative of interest. For the years 1997, 1996, 1995, 1994 and 1993, earnings were insufficient to cover fixed charges by $221.0 million, $116.2 million, $54.1 million, $31.0 million and $23.2 million, respectively.

Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

Overview

TCG, the first and largest CLEC in the United States, offers comprehensive telecommunications services in major metropolitan markets nationwide. The Company competes with ILECs by providing high quality, integrated telecommunications services, primarily over fiber optic digital networks, to meet the voice, data and video transmission needs of its customers. TCG's customers are principally telecommunications intensive-businesses, healthcare and educational institutions, governmental agencies, long distance carriers and resellers, *Recent Sales of Unregistered Securities*

During 1997, the Registrant issued (i) an aggregate of 2,100,000 shares of Class A Common Stock in connection with the acquisition of CERFnet, (ii) 2,757,083 shares of Class A Common Stock in connection with the acquisition of ETC, and (iii) 1,667,624 whole shares of Class A Common Stock in connection with the acquisition of BizTel. See ''Business—Other Recent Developments.'' The issuance of Class A Common Stock in each acquisition was deemed exempt from the registration requirements of the Securities Act pursuant to Section 4(2) of the Securities Act of 1933, as amended. The recipients of Class A Common Stock in each transaction represented their intentions to acquire the Class A Common Stock for investment purposes only and not with a view to or for sale in connection with any distribution of Class A Common Stock.

Item 6. ***Selected Financial Data***

The following tables present historical summary combined financial data for the years 1993, 1994 and 1995, derived from the combined audited historical financial statements of TCG and TCG Partners. The selected financial data set forth below for the years 1996 and 1997 have been derived from the consolidated financial statements of TCG. The financial statements for the years 1995 through 1997 have been audited by Deloitte & Touche LLP, independent auditors, whose report thereon appears elsewhere in this Form 10-K.

	Years Ended December 31,				
	1997	**1996**	**1995**	**1994**	**1993**
	(dollars in thousands, except share amounts)				
Statements of Operations Data:					
Revenues:					
Telecommunications service	$ 494,304	$ 244,864	$ 134,652	$ 99,983	$ 82,374
Management and royalty fees(1)	—	22,805	31,517	20,691	1,555
Total Revenues	494,304	267,669	166,169	120,674	83,929
Operating expenses	283,440	157,591	93,118	76,572	54,218
Selling, general and administrative expenses(2)	165,977	85,025	50,475	39,989	34,281
In-process research and development costs(3)	22,000	—	—	—	—
Depreciation and amortization	155,402	78,416	37,837	19,933	16,197
Operating loss	(132,515)	(53,363)	(15,261)	(15,820)	(20,767)
Interest:					
Interest income	31,111	30,219	4,067	1,711	1,072
Interest expense	(116,172)	(73,633)	(23,331)	(5,079)	(1,407)
Net Interest expense	(85,061)	(43,414)	(19,264)	(3,368)	(335)
Minority interest(4)	—	3,520	663	1,395	796
Equity in losses of unconsolidated affiliates	(3,427)	(19,400)	(19,541)	(11,763)	(2,114)
Loss before income taxes	(221,003)	(112,657)	(53,403)	(29,556)	(22,420)
Income tax (provision) benefit	(1,664)	(2,193)	(401)	(433)	4,149
Net loss	$ (222,667)	$ (114,850)	$ (53,804)	$ (29,989)	$ (18,271)
Net loss per share	$ (1.34)	$ (1.00)	$ (0.77)	$ (0.43)	$ (0.26)
Weighted average number of shares	165,728,059	114,443,695	70,000,140	70,000,140	70,000,140
Other Data:					
EBITDA(5)	$ 44,887	$ 25,053	$ 22,576	$ 4,113	$ (4,570)
Cash flows from operating activities	(21,211)	93,618	36,141	87,753	47,438
Cash flows from investing activities	(341,624)	(913,513)	(207,967)	(265,026)	(149,107)
Cash flows from financing activities	258,626	1,085,573	157,688	171,557	129,822
Capital expenditures(6)	501,035	308,112	154,807	143,276	155,184
Ratio of earnings to fixed charges(7)	—	—	—	—	—

The Company believes that these proceedings, individually and in the aggregate, are without merit and that any associated costs will not have a material adverse effect on TCG's financial condition, results of operations or cash flows.

The Company is a party to various claims and legal proceedings arising in the ordinary course of business. The Company does not believe that such claims or proceedings, individually or in the aggregate, will have a material adverse effect on the Company's financial condition or results of operations.

Item 4. *Submission of Matters to a Vote of Security Holders*

Pursuant to the provisions of the Amended and Restated Stockholders' Agreement, dated as of June 26, 1996, among the Company and the Cable Stockholders, by unanimous vote of each of the holders of the Company's Class B Common Stock on November 19, 1997, John R. Alchin, having been designated a nominee by Comcast, was elected as a Director of the Company to fill the vacancy created by the resignation of Brian L. Roberts.

Pursuant to a Voting Agreement among the Cable Stockholders and AT&T, each Cable Stockholder executed and delivered to TCG a written consent, dated January 8, 1998, in favor of and approving the AT&T Agreement and the AT&T Merger. As a result, so long as the AT&T Agreement is not amended and no provision of it is waived, no further vote or meeting of TCG stockholders is necessary to approve or consummate the AT&T Merger. See "Business—The AT&T Merger."

PART II

Item 5. *Market Price for Registrant's Class A Common Stock and Related Stockholder Matters*

Price Range of Class A Common Stock

The Registrant's Class A Common Stock commenced trading on the Nasdaq National Market on June 27, 1996 under the symbol "TCGI". As of March 5, 1998, the last reported sale price of the Class A Common Stock was $54⅜. As of March 4, 1998, there were approximately 12,410 holders of record of the Class A Common Stock. The following table sets forth the high and low sale prices of the Class A Common Stock as reported by the Nasdaq National Market for each of the quarters in the period commencing June 27, 1996 through the quarter ended December 31, 1997.

	High	Low
1996		
Second Quarter	$19⅛	$16
Third Quarter	27⅜	14⅛
Fourth Quarter	35⅜	22
1997		
First Quarter	35¼	22⅝
Second Quarter	34⅛	21
Third Quarter	46⅛	33½
Fourth Quarter	60 7/32	44¼

Dividend Policy

The Registrant has never paid or declared dividends on its capital stock and intends to retain future earnings to finance the development and expansion of its networks and operations. The Registrant does not anticipate paying any cash dividends in the foreseeable future on its capital stock. Any decision whether to pay cash dividends will be made by the Company's Board of Directors in light of the conditions then existing, including the Company's results of operations, financial condition and requirements, business conditions and other factors. In addition, the Indentures governing the Registrant's 9⅞% Senior Notes due 2006 and 11⅛% Senior Discount Notes due 2007 contain covenants which may limit the ability of the Registrant to pay dividends on the Class A Common Stock.

The Company leases network hub sites and other facility locations and sales and administrative offices in each of the cities in which it operates networks. During the years ended December 31, 1996 and 1997, rental expense for operating leases totaled $18.0 million and $31.4 million, respectively. On a pro forma basis, rental expense for operating leases totaled $20.4 million for the year ended December 31, 1996. The Company has no significant real estate holdings. Management believes that its properties, taken as a whole, are in good operating condition and are suitable and adequate for the Company's business operations. The Company currently leases approximately 200,000 square feet of space at The Teleport complex in Staten Island, New York, where it maintains its headquarters, approximately 190,000 square feet in Dayton, New Jersey, where its principal executive offices are located, and approximately 70,000 square feet in Englewood, Colorado where its National Customer Care Center is located.

Item 3. *Legal Proceedings*

In April 1997, a complaint was filed seeking damages in an unspecified amount against the Company in the Circuit Court of Cook County, Illinois by two former customers of the Company and an alleged class purporting to consist of investors in one of the customers, alleging fraud and breach of contract. The initial complaint was dismissed in September 1997 and an amended complaint was refiled by the plaintiffs in October 1997. The Company believes that the allegations are without merit and that it possesses meritorious counterclaims for damages arising from breach of contract. The Company additionally believes that any costs arising from this lawsuit will not have a material adverse effect on its financial condition, results of operations or cash flows.

On December 16, 1997, prior to public announcement of the AT&T Merger, an action was filed by one TCG public stockholder in the Delaware Court of Chancery against TCG, TCG's directors and the Cable Stockholders. The plaintiff's complaint alleges that, based on public reports, TCG's directors, management and controlling stockholders were negotiating the sale of TCG to AT&T on a preferential basis. This sale on a preferential basis, the complaint alleges, would offer little or no premium over the current market price of TCG Class A Common Stock and is therefore unfair and inadequate to TCG's public stockholders. The plaintiff seeks to enjoin the merger of TCG and AT&T or, alternatively, to rescind the transaction and/or recover damages in the event that the transaction is consummated. The complaint seeks to have the action certified for class action status and to appoint the plaintiff as the class representative.

On January 12, 1998, an action was filed by two TCG public stockholders in the Delaware Court of Chancery against TCG, certain TCG directors and officers, the Cable Stockholders and AT&T. The complaint alleges that the exchange ratio in the AT&T Merger represents an inadequate premium for stockholders of TCG Class A Common Stock. The complaint further alleges that the actions of the TCG directors, officers and Cable Stockholders in connection with the AT&T Merger constitute a breach of various fiduciary duties owed to the stockholders TCG Class A Common Stock. The plaintiffs seek to enjoin the merger of TCG and AT&T or, alternatively, to rescind the transaction and/or recover damages in the event that the transaction is consummated. The complaint seeks to have the action certified for class action status and to appoint the plaintiffs as the class representatives.

On January 28, 1998, an action was filed by a TCG public stockholder in the Delaware Court of Chancery against TCG, certain TCG directors and officers, and the Cable Stockholders. The complaint alleges that the exchange ratio in the AT&T Merger represents an inadequate premium for stockholders of TCG Class A Common Stock. The complaint further alleges that the actions of the TCG directors, officers and Cable Stockholders in connection with the AT&T Merger constitute a breach of various duties owed to the stockholders of TCG Class A Common Stock. The plaintiffs seek to enjoin the merger of TCG and AT&T or, alternatively, to rescind the transaction and/or recover damages and fees in the event that the transaction is consummated. The complaint seeks to have the action certified for class action status and to appoint the plaintiff as the class representative.

Plaintiffs' counsel in the above three putative stockholder class action proceedings have agreed (i) to defer the obligation of the defendants to answer the actions and (ii) to consolidate the actions by filing an amended consolidated complaint. As of the end of February 1998, the amended consolidated complaint had not been filed.

the holders of TCG Class B Common Stock no longer represent at least 50% of the voting power of the outstanding TCG Common Stock, without the affirmative vote of the holders of a majority of the TCG Class B Common Stock, subject to certain exceptions.

Item 2. *Properties*

The Company uses the latest technologies and network architectures to develop a highly reliable infrastructure for delivering high speed, quality digital transmission of voice, data and video telecommunications. The basic transmission platform consists primarily of optical fiber equipped with high capacity SONET equipment deployed in self-healing rings. These SONET rings give TCG the capability of routing customer traffic simultaneously in both directions around the ring thereby eliminating loss of service in the event of a cable cut. The Company extends SONET rings or point-to-point links from rings to each customer's premises over its own fiber optic cable, unbundled facilities obtained from ILECs, microwave (including 38 GHz milliwave) transmission facilities (primarily provided by BizTel) and other technologies. TCG also installs diverse building entry points where a customer's security needs require such redundancy. TCG then places necessary customer-dedicated or shared electronic equipment at a location near or in the customer's premises to terminate the link.

TCG serves its customers from one or more nodes or hubs strategically positioned throughout its networks. The node houses the transmission and switching equipment needed to interconnect customers with each other, the IXCs and other local exchange networks. Redundant electronics, with automatic switching to the backup equipment in the event of failure, protect against signal deterioration or outages. Continuous monitoring of system components focuses on proactively avoiding problems rather than just reacting upon failure.

TCG adds switched, dedicated. Internet and data services to its basic fiber optic transmission platform by installing sophisticated digital electronics at its network nodes and at customer locations. TCG's advanced ISDN-capable digital telephone switches are connected to multiple ILEC and long distance carrier switches to provide TCG's customers access to every telephone in the local market as well as across the country and around the world. Similarly, TCG provides ATM switched and LAN multiplexers at the customer's premises and in its nodes to provide high speed LAN interconnection and native ATM services.

The Company's strategy for adding customers is designed to maximize the speed and impact of its marketing efforts while maintaining attractive rates of return on capital invested to connect customers directly to its networks. To initially serve a new customer, for example, TCG may use various transitional links, such as reselling a portion of the ILEC's network and, where appropriate, using alternative transmission technologies such as microwave transmission, including 38 GHz milliwave. Once the new customer's communications volume and product needs are identified, the Company may build its own fiber optic connection between the customer's premises and its networks to accommodate (i) the customer's current and future telecommunications needs and (ii) TCG's efforts to maximize return on network investment.

In determining which new markets to enter, the Company carefully analyzes the potential customer base and competitive condition within the market. The Company is planning on building new facilities, entering into fiber leases, and other arrangements with cable television companies and other carriers, acquiring existing telecommunications providers and exploring new technologies that have potential to enhance network expansion (such as the use of microwave radio facilities). The Company also seeks to utilize relationships with the Cable Stockholders or other cable television operators which have an existing presence in the market and with which TCG may be able to develop a fiber optic network rapidly and efficiently. As a facilities-based carrier, the Company utilizes a variety of means to expand geographically, including rights-of-way, easements, poles, ducts and conduits that are available from cable television operators, incumbent local exchange carriers, railways, subways, electric, gas and water utilities and municipal, state and federal street and highway authorities. TCG plans to continue making selected acquisitions of existing local telecommunications networks in markets in which it has existing local telecommunications operations or which are geographically proximate to such markets, as well as in markets that are otherwise attractive to TCG. The Company's use of BizTel as its primary and preferred provider of 38 GHz services offers the Company the opportunity to market telecommunications facilities to customers in geographical areas where the Company has not yet constructed, and may not find it economical to construct, fiber optic facilities.

The 1996 Act is intended to increase competition in the local telecommunications business. The 1996 Act requires all local exchange providers, including the Company and new entrants, to interconnect with other carriers, and to offer their services for resale and requires ILECs to offer their substantial network facilities on a discounted wholesale basis and on an unbundled basis. These requirements may facilitate entry by new competitors without substantial capital risk or investment. However, there can be no assurance that any rates or facilities offered by ILECs to TCG or other CLECs will be economically attractive or technically viable.

The Company believes that the 1996 Act will provide it with increased business opportunities and potentially better margins by opening all local markets in urban areas to competition and by requiring ILECs to provide improved direct interconnection at lower cost. However, under the 1996 Act, the FCC and some state regulatory authorities may provide ILECs with increased flexibility to reprice their service as competition develops and as ILECs allow competitors to interconnect to their networks. In addition, some new entrants in the local market may price certain services to a particular customer or for a particular route below the prices charged by the Company for services to that customer or for that route, just as the Company may itself underprice those new entrants. If ILECs and other competitors lower their rates and can sustain significantly lower prices over time, this may adversely affect revenues and margins of TCG. If regulatory decisions permit the ILECs to charge CLECs substantial fees for interconnection to the ILECs' networks or afford ILECs other regulatory relief, such decisions could also have a material adverse effect on TCG. However, TCG believes that the negative effects of the 1996 Act may be more than offset by (i) increased revenues available as a result of being able to address the entire urban local exchange market, (ii) mutual reciprocal compensation with the ILEC that could eventually result in TCG terminating its local exchange traffic on the ILEC's network at little or no net cost to TCG, (iii) obtaining access to off-network customers through more reasonably priced expanded interconnection with ILEC networks and (iv) a shift by IXCs to purchase access services from CLECs instead of ILECs. There can be no assurance, however, that these anticipated results will offset completely the effects of increased competition as a result of the 1996 Act.

Currently, TCG's services are predominantly local and regional, although TCG has begun to offer long distance services in order to provide a full range of telecommunications services to those customers who prefer to obtain most or all of their telecommunications services from one provider. However, TCG has examined from time to time, and will continue to examine, opportunities to expand its provisioning of other related telecommunications services. The merger with ACC represents an expansion of TCG's long distance services, including international long distance, and provision of local services in foreign countries. To the extent that the Company expands its provisioning of telecommunications or Internet services, it could incur certain additional risks in connection with such expansion, including technological compatibility risks, legal and regulatory risks and possible adverse reaction by some of its current customers.

All of the Cable Stockholders are in the telecommunications business and may, now or in the future, provide services which are the same or similar to those provided by TCG. In addition, affiliates of TCI, Cox and Comcast, which collectively have designated a majority of the directors of the Company, together with an affiliate of Sprint, have formed Sprint PCS, a partnership created to provide certain wireless telecommunications services. Also, affiliates of TCI, Cox and Comcast are principal owners of At Home, a provider of Internet related services over the @Home™ Network. No assurance can be given that the Cable Stockholders will not compete with TCG in certain markets or in the provision of certain telecommunications services. Although directors of TCG who are also directors, officers or employees of the Cable Stockholders or any of their respective affiliates have certain fiduciary obligations to TCG under Delaware law, such directors and the Cable Stockholders, as the controlling stockholders of TCG, are in positions that may create conflicts of interest with respect to certain business opportunities available to and certain transactions involving the Company. The Cable Stockholders have not adopted any special voting procedures to deal with such conflicts of interest, and there can be no assurance that any such conflict will be resolved in favor of TCG. In this regard, TCG's Amended and Restated Certificate of Incorporation provides that TCG may not provide certain (i) wireless communications services (other than products and services delivered via point-to-point microwave and milliwave transmissions) or (ii) telecommunications services to residences until, in each case, the earlier of June 26, 2001, or the date on which

The Company generally offers its services in accordance with applicable tariffs filed with the FCC (for interstate services) and State PUCs (for intrastate services). As a non-dominant carrier, TCG does not have to cost-justify its rates and frequently enters into customer and service specific arrangements. The services offered by TCG are typically priced at a modest discount to the prices of the ILECs.

With a direct sales force in each of its markets, TCG initially targets the large telecommunications-intensive businesses concentrated in the major metropolitan markets served by its networks. The Company's customers in these markets include financial services firms, media and health care companies and educational and governmental institutions. In addition, TCG markets its services through sales agents, landlords, advertisements, trade journals, media relations, direct mail and participation in trade conferences.

The Company is increasing its marketing to small and medium-sized business customers. The Company's strategies for addressing this market include (i) hiring and training specialized account executives dedicated to developing this market; (ii) increased marketing to this class of customers in office buildings or multiple dwelling units already served by TCG's network; (iii) developing special services and packages of services attractive to this market segment; and (iv) employing 38 GHz wireless technology to reach these customers cost-effectively.

TCG also targets long distance carriers and resellers, ISPs, disaster recovery service providers and wireless telephone companies through its national sales organization. The Company has master services agreements (which generally set forth technical standards, ordering processes, pricing methodologies and service grade requirements, but do not guarantee any specified level of business for TCG) with a significant number of long distance carriers. For example, AT&T considers TCG a preferred national supplier of dedicated and switched access services. By providing long distance companies a local connection to their customers, the Company enables these carriers to avoid complete dependence on the ILECs for access and to obtain a high quality, reliable local connection at savings over the ILECs' charges. The national scope of the Company's local networks allows it to offer high volume business customers and long distance carriers uniformity of services, pricing, quality standards and customer service. In addition, the Company has arrangements with other telecommunications providers, including shared tenant service providers, cable television companies and long distance carriers, to resell TCG's services. TCG has engaged in technical trials pursuant to which certain long distance carriers have resold TCG local exchange service and intraLATA toll service bundled with their long distance service. These trials began in the second half of 1995, but as of March 1998 all had been terminated. TCG and AT&T are currently in the process of developing a combined local and long distance business line product which would be sold under the AT&T brand name, initially as a trial.

The AT&T Merger could make some competitors of AT&T less likely to continue or to expand their relationship with TCG. TCG believes that most or all of the major long distance carriers are pursuing alternatives to their current practices with regard to obtaining local telecommunications services.

COMPETITION

The Company faces substantial and increasing competition in each of the metropolitan areas it serves or plans to serve from entities that offer services similar to those offered by TCG, including ILECs such as Ameritech, Bell Atlantic, BellSouth, SBC Communications, U S WEST and GTE. The Company believes that ILECs generally benefit from their long-standing relations with customers, substantial technical and financial resources, established ubiquitous networks and federal and state regulations that could provide them with increased pricing flexibility as competition increases. In addition, in most of the metropolitan areas in which the Company currently operates, at least one, and sometimes several, other CLECs offer substantially similar services at substantially similar prices to those of the Company. Other CLECs, ILECs entering new geographic markets, cable television companies, electric utilities, long distance carriers, microwave carriers, wireless telephone system operators and private networks built by large end users may offer services similar to those offered by the Company. In addition, the current trend of actual and proposed business combinations and alliances in the telecommunications industry, which include mergers between ILECs, between IXCs and international carriers and between IXCs and CLECs, may create significant new competitors for the Company.

premises with CERFn'WEB SM services or may colocate its server at a CERFnet facility connected directly to CERFnet's Internet backbone with WEB SuperSite SM services. CERFnet also offers Internet training and consulting including the design of World Wide Web sites.

Video Services

TCG provides analog video link services to its media industry customers, including all of the major television networks as well as to many cable services and independent programmers. TCG's video services include offering a broadcast quality, analog channel which can be provided on a point-to-point or point-to-multipoint basis.

Wireless Services

OmniWave SM services, TCG's 38 GHz digital milliwave private line service, supports capacities of 4 DS-1s, 8 DS-1s and 1 DS-3. These services can be multiplexed at either end of the circuit to provide lower levels of bandwidth. OmniWave services utilize a broadband milliwave transmission spectrum for quality and reliability that is comparable to that achieved by conventional fiber optic networks. BizTel is TCG's primary and preferred provider of these services.

Residential Services

TCG currently offers residential telephony services on a retail basis in several multiple dwelling units and in a number of single family residences and continues to develop services for this market. TCG provides wholesale local exchange services that are suitable for reselling to residential consumers, including local and long distance toll usage, features and auxiliary functions such as network provisioning, installation, customer service, billing, operator services, and directory assistance. TCG's wholesale customers, which resell these services to individual users, include landlords, real estate development and management companies and the Cable Stockholders.

Calling Card Services

In August 1997, TCG commenced offering a full service long distance calling card with specialized features designed for business travelers, called PrimeCard SM service.

Customers and Marketing

The Company's customers are principally telecommunications-intensive businesses, healthcare, and educational institutions, governmental agencies, long distance carriers and resellers, ISPs, disaster recovery service providers and wireless communications and financial services companies. In 1985, TCG's customers were primarily long distance carriers. While the Company's carrier business has continued to grow, in 1997 all other customers (including resellers) accounted for approximately 66% of the Company's total revenues. During 1997, the Company's 10 largest customers accounted for approximately 40% of TCG's total revenues. During that period, no customer accounted for more than 10% of such revenues.

The Company has sought to establish "TCG"® "Prime-" and "Omni-" as recognized brand names for its services and products. TCG has partially rebranded the Internet services of its CERFnet subsidiary as "TCG CERFnet" services. The Company's marketing emphasizes its state-of-the art digital networks, flexibly priced products and services, responsive customer service orientation and integrated operations, customer support and network monitoring and management systems. For large telecommunications-intensive businesses that depend on accurate and reliable telecommunications, the Company promotes the operational and strategic security achieved through vendor and facility diversity. The Company's centrally managed customer care and support operations are designed to facilitate the installation of new services and the processing of orders for changes and upgrades in TCG customer services. The Company seeks to be among the first to introduce new telecommunications products and service, thereby increasing usage among existing TCG customers and attracting new customers to the Company's networks.

DS-1. A high speed digital channel that typically links customer locations to long distance carriers or other customer locations. Used for multiple voice or data transmission, access to the Internet and interconnection of LANs, DS-1 services accommodate digital data transmission capacity of up to 1.544 megabits per second (''mbps''), the equivalent of 24 voice grade circuits.

European-Standard DS-1(E-1). The Company was the first U.S.-based local carrier to offer this dedicated high capacity service, which allows customers to accommodate their international traffic with a digital data transmission capacity of up to 2.048 mpbs, which is equivalent to 30 voice grade equivalent circuits. This dedicated service offers international business customers the flexibility to connect their United States locations to international circuits that operate at the high capacity European standard transmission speed.

DS-3. With digital data transmission capacity of up to 44.736 mbps, this dedicated service provides a very high capacity digital channel, which is equivalent to 28 DS-1 circuits or 672 voice grade equivalent circuits. This digital service is used by long distance carriers for central office connection and by some large corporate users to link multiple sites. It is also used for data services applications.

TCG OmniRing^{SM}. This service provides a standard Optical Carrier (''OC'') service for those customers requiring enhanced network survivability, advanced network architectures and centralized network monitoring and management capabilities. With TCG OmniRing customers enjoy the benefits of dedicated private local OC3 or OC12 synchronous optical network (''SONET'') rings between various customer-designated sites and the Company's nodes.

Data Services

The Company offers its customers a broad array of data services that enable customers to create their own internal computer networks and access external computer networks and the Internet. In 1992, TCG introduced its native speed LAN inter-networking data service which is used to connect workstations and personal computer users on one or more LANs. Called OmniLAN^{SM}, this service provides users with transmission capacity for 10 mbps Ethernet, 4 and 16 mbps Token Ring and 100 mpbs FDDI LAN interconnections. Native speed services avoid the bottleneck problems that are frequently encountered with customary DS-1 connections by providing the customer with a circuit that matches the transmission speeds of its LAN. OmniLAN provides dedicated circuits, guaranteed transmission capacity and guaranteed bandwidth for virtually all LAN applications. Users can share files and databases as if they were all working on the same computer, or within the same LAN. In 1996, TCG introduced Fast Ethernet LAN Interconnect Service for business customers which have or plan to build Fast Ethernet networks and require native speed connections between geographically disparate LANs.

As companies and communications become more sophisticated, there is an increased need for customer access to superior traffic management of sensitive data, video and voice transmission within a single metropolitan area or between various company operations. TCG's switched data services, called OmniStream^{SM}, offer sophisticated switched data services over TCG's SONET/ATM backbone and provide high standards in reliability and flexibility while enabling users to reduce the costs associated with interconnecting various geographically dispersed and architecturally diverse information systems. TCG's asynchronous transfer mode (''ATM'') platform supports evolving high-speed applications, such as multimedia, desktop video conferencing and medical imaging. Additionally, TCG's services allow users to interconnect both high speed and low speed LAN environments. Customers also benefit from flexible billing, as well as detailed usage reports.

Internet Services

The Company accommodates its customers' demand for Internet services directly through CERFnet, an ISP, and indirectly by providing the connection between a customer and an ISP. CERFnet's services include a full range of Internet-related services for businesses and professionals. These services include basic Internet dial up access for professionals and small businesses, marketed as DIALn'CERF^{SM} services, and dedicated Internet access for larger customers at speeds ranging from 56 kbps to DS-3, as well as LAN connections. CERFnet also provides World Wide Web hosting services; the customer may choose to locate its Internet server on its own

PrimeNBX℠. This service gives voice and data customers a choice for analog, digital voice-only and ISDN Centrex telephone lines to customers' desktops. With PrimeNBX, TCG owns, houses, manages and maintains the switch. PrimeNBX allows customers to retain control over network configurations. Lines can be added, deleted and moved as needed. Business customers can utilize TCG as their primary Centrex provider, as a supplement to the ILEC's Centrex service, or as an addition to a fully-utilized customer owned private branch exchange ("PBX").

PrimeXpress℠. This service is utilized by PBX users to provide access to the local, regional and long distance telephone networks. PBX customers may use either TCG's telephone numbers or their ILEC-assigned telephone numbers. Customer access to TCG's network is accomplished by a DS-1 digital connection or analog trunks between the customer's PBX port and TCG's switching centers.

PrimePath℠. This service enables customers to connect to the TCG network using Prime Business Lines or Prime Business PBX Trunks. PrimePath is available in a variety of feature packages which have been developed to serve TCG customers, with features such as Call-Waiting, Call-Forwarding, Conference Calling and PrimeMail voice mail.

PrimePlus℠. This service provides customers with a competitive alternative to ILEC service for intraLATA toll calls. It is a customized, high quality calling plan available to PrimeNBX, PrimePath and PrimeXpress customers. TCG works with customers to devise cost-saving intraLATA calling programs based on actual usage and calling patterns.

PrimeOne℠. This service is basic local exchange service which can be tailored to a customer's particular calling requirements. Local telephone service includes operator and directory assistance services, as well as an intraLATA toll plan.

TCG Pay Phone Services provide full public pay telephone service to public customers and dial tone services and access lines to other public pay telephone providers, including pay telephone services at several major airports. TCG is the primary provider of public pay phone service for all properties of The Port Authority of New York and New Jersey, including Kennedy, La Guardia and Newark airports.

Switched Access Services provide IXCs with switched connections to their customers for the origination and termination of long distance telephone calls.

Integrated Services Digital Network ("ISDN") **PrimePlex℠ Services** provide TCG's customers with multiple voice and data communications services over a single telecommunications line. The Company's ISDN services allow customers to perform multiple functions such as simultaneous voice and computer links, and enable the Company to offer customers value-added features. High speed ISDN applications include desk top video conferencing, interconnection of local area networks ("LANs") and Internet access.

Advanced Intelligent Network ("AIN") **Services**, utilizing the Bellcore ISCP™ format, offer customers advanced, customized switching features which may include local number portability.

Dedicated Services

TCG's dedicated services, which include special access and digital private line services, use high-capacity digital circuits to carry voice, data and video transmission from point-to-point in flexible configurations involving different standardized transmission speeds and circuit capacities, including:

DS-0. A dedicated service that accommodates business communications with digital data transmission through a voice grade equivalent circuit with a capacity of up to 64 kilobits per second ("kbps"). This service offers a private line digital channel for connecting telephones, fax machines, personal computers and other telecommunications equipment. Multiple DS-0 services are offered in a variety of combinations, depending on the particular application and can also provide voice grade analog connections.

Much of the language used in the Basic Telecom Agreement resembles language in the 1996 Act. The most far-reaching paragraph in the primary reference document provides that interconnection with a major supplier will be ensured "at any technically feasible point in the network," under non-discriminatory terms and conditions, in a timely fashion under terms, conditions (including technical standards) and cost-oriented rates that are transparent, reasonable, and sufficiently unbundled that the competitive entrant will not need to pay for network components or facilities that it does not require. In the United States, similar language is interpreted as requiring incumbent local exchange telephone companies to provide unbundled local loops at cost-based rates and to allow interconnection with the competitive supplier's network at the telephone company's switching office. It remains to be seen how other countries will interpret that language, and to what extent they will adopt and enforce regulations encouraging competitive entry.

In the United States, there has been extensive litigation and disputes over the terms, conditions and implementation of interconnection. It is reasonable to assume that the process of implementing other countries' commitments under the Basic Telecom Agreement will be at least as difficult. The United States had a quarter century of experience with various forms of telecommunications competition before the 1996 Act was adopted, but most other countries have had far less experience with competition. As far-reaching as the WTO Basic Telecom Agreement may appear on its face, it will be meaningful only to the extent that it is effectively enforced. The WTO dispute resolution process will not be freely accessible to any company that considers itself an injured party. Under United States law, no person other than the United States government itself will have any cause of action or defense before the WTO. This is consistent with the WTO's Dispute Annex, which itself provides an opportunity for action or defense only by WTO members, that is, governments. The implication is that national governments both in the United States and in other countries will serve as gatekeepers and will exercise their sovereign authority to choose which cases to litigate. Thus, TCG's ability to invoke any rights provided by the Basic Telecom Agreement will be dependent upon the willingness of a host government to pursue issues of concern to TCG. TCG can provide no assurance that the United States or any other host government will be willing to pursue TCG's concerns through the WTO dispute resolution process or that, if such a government were willing to do so, that it would obtain a favorable ruling from the WTO.

THE COMPANY'S SERVICES

The Company provides its customers with a comprehensive array of local and long distance telecommunications services, including basic local exchange telephone services, enhanced switched services, Internet services, national and international toll services, 800 services, dedicated services, high-speed switched data services, disaster avoidance services and video channel transmission services. Switched voice services offered by the Company primarily use high-capacity digital switches to route voice transmission anywhere on the public switched telephone network. TCG's dedicated services, which include private line and special access services, use high-capacity digital circuits to carry voice, data and video transmission from point-to-point in multiple configurations. The Company provides its media industry customers with point-to-point, broadcast-quality video channels for video transmission between two or more locations, including video link services to major television networks as well as to other programmers. The Company also provides private network management and systems integration services for businesses that require combinations of various dedicated and switched telecommunications services.

Switched Services

TCG's switched services provide customers with local dial tone and local and regional calling capabilities and connection to their IXCs. TCG's switched services are mainly branded under the "Prime" name and include the following:

PrimeDistance^{SM}. This service is a long distance service which is offered as a package to TCG's customers for local services. It is a broad service including national and international toll services, 800 services, directory assistance, operator services and fraud detection features.

Local Government Authorizations. TCG may be required to obtain from municipal authorities in certain cities street opening and construction permits and other rights-of-way to install and expand its digital networks. In some cities, TCG's affiliates or subcontractors may already possess the requisite authorizations to construct or expand TCG networks.

In some of the metropolitan areas where TCG provides network services, TCG may pay license or franchise fees. There can be no assurance that municipalities that do not currently impose fees will not seek to impose fees in the future, nor is there any assurance that following the expiration of existing authorizations, fees will remain at their current levels. Under the 1996 Act, such fees must be fair and reasonable, applied on a competitively neutral and non-discriminatory basis and be publicly disclosed by the relevant governmental entity. There can be no assurance, however, that municipalities that currently favor the ILECs will conform their practices in a timely manner or without legal challenges by TCG or another CLEC. In September 1996, TCG filed suit in federal district court alleging that the City of Dearborn, Michigan acted in an unlawful and discriminatory manner in imposing a fee equal to a percentage of gross revenues for its use of public rights-of-way, which fee is not imposed on the local ILEC (Ameritech Michigan) in violation of applicable state law and Section 253(c) of the 1996 Act. TCG's suit is currently pending in the U.S. District Court for the Eastern District of Michigan (Southern Division). The City of Dearborn has asserted counterclaims against TCG and motions for summary judgment by both parties are pending. In addition, in July 1996, a subsidiary of TCG, Teleport Communications (New York) ("TCNY") filed suit in U.S. District Court in Newark, New Jersey alleging that an ordinance adopted by the Township of Bloomfield, New Jersey imposing a fee per linear foot per year for the right to use a public right-of-way is unlawfully discriminatory, in violation of the United States Constitution and Section 253(c) of the 1996 Act. The lawsuit has been settled and the Township of Bloomfield has enacted a new ordinance. In addition, in February 1997 the City of Chattanooga joined TCG in a pending action in the U.S. District Court for Eastern Tennessee seeking to interpret the nondiscriminatory and competitively neutral requirements of Section 253(c) of the 1996 Act. On October 24, 1997, the District Court granted the defendants' motion for summary judgment, ruling that the City's franchise requirements violated state law.

TCNY and the City of New York entered into a Franchise Agreement, dated as of May 2, 1994 (the "New York Franchise") pursuant to which the City of New York granted TCNY the non-exclusive right for a term of fifteen years to provide Telecommunications Services (as defined in the New York Franchise) in the City of New York. In addition to other payments specifically required by the New York Franchise, the New York Franchise requires that TCNY pay to the City of New York as an annual franchise fee an amount based on a percentage of TCNY's gross revenues. TCG is restricted under the terms of the New York Franchise from providing cable service or mobile telecommunications services in the City of New York.

Regulation of International Services. TCG is authorized to provide resale and facilities-based international telecommunications services to its customers in the United States. If its acquisition of ACC is completed, TCG will provide international telecommunications services to customers in Canada, the United Kingdom, and Germany, and it will become a reseller of local telephone service in Ontario and Quebec, Canada. Thus, the regulatory situations in Canada, the United Kingdom, and to a lesser extent in Germany will have an immediate impact on business operations that TCG is proposing to acquire in those countries. TCG will also be affected by the regulatory situation in additional countries, both because its customers communicate with other places around the world and because other urban centers can provide TCG with expansion opportunities applying its expertise in the provision of competitive local exchange services.

On February 15, 1997, delegations from 69 countries concluded an historic series of negotiations by indicating their conditional acceptance of the World Trade Organization ("WTO") Agreement on Basic Telecommunications Services ("the Basic Telecom Agreement"). Countries representing approximately 82 percent of world telecommunications revenues and approximately 79 percent of the world economy committed themselves to open their telecommunications markets, including local telephone exchanges, to competition by 1998, conditional upon ratification and implementing acts by all of the signatory countries. On January 26, 1998, a meeting of WTO members agreed that the pact would enter into force on February 5, 1998, despite the fact that a handful of signatory countries representing less than 5 percent of world telecommunications traffic had not completed the ratification process.

universal service levies are at various stages of enactment, and are likely to take effect no later than the first quarter of 1999. Those rates will vary from state to state and TCG cannot predict what the levy rates will be at this time.

A number of parties have challenged the FCC's universal service order and the cases have been consolidated in the U.S. Court of Appeals for the Fifth Circuit. Either the FCC's reconsideration of its rules or a judicial determination could result in a change in CLEC support payments required for federal universal service programs. Parties sought stays of the rules from both the FCC and the Fifth Circuit. On October 21, 1997, the Fifth Circuit denied those requests.

Other 1996 Act Provisions. The 1996 Act contains other provisions that potentially could affect TCG's business, which may be subject to FCC rulemaking and judicial interpretation, including a provision that limits the ability of a cable television operator and its affiliates to acquire more than a 10% financial interest or any management interest in an ILEC or CLEC that provides local exchange service in such cable operator's franchise area.

Telephone Number Portability Issues. On July 2, 1996, the FCC released its First Report and Order and Further Notice of Proposed Rulemaking promulgating rules and regulations to implement Congress' statutory directive concerning number portability (the "Number Portability Order"). The Number Portability Order was modified on March 6, 1997. As modified, the Number Portability Order requires all ILECs and CLECs to begin phased deployment of a long-term service provider portability method in the 100 largest MSAs no later than October 1, 1997, and to complete deployment in those MSAs by December 31, 1998 for all MSAs in which another carrier has made a specific request for the provision of portability. After December 31, 1998, each ILEC and CLEC must make number portability available within specific time frames after receiving a specific request by another telecommunications carrier. Until long-term service portability is available, ILECs and CLECs must provide interim versions of number portability as soon as reasonably possible after a specific request from another carrier.

On August 18, 1997, the FCC released its Second Report and Order on number portability, implementing various specific aspects of the number portability program. As new carriers are at a competitive disadvantage without telephone number portability, the Number Portability Orders should enhance the ability of TCG to offer service in competition with the ILECs, but it is uncertain how effective these regulations will be in promoting number portability. The Number Portability Order does not address how the costs of implementing long-term service portability, which could be substantial, will be recovered.

State Regulation. Most State PUCs require carriers that wish to provide local and other jurisdictionally intrastate common carrier services to be authorized to provide such services. TCG's operating subsidiaries are authorized to provide local exchange services in Alabama, Arizona, California, Colorado, Connecticut, Delaware, the District of Columbia, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Virginia, Washington and Wisconsin. TCG expects to file for CLEC authority in a number of additional states, and to seek geographically broadened authority in states in which it already holds CLEC authority for portions of the state.

TCG typically is not subject to price regulation or to rate of return regulation for its intrastate services. In most states, TCG is required to file tariffs setting forth the terms, conditions and prices for its intrastate services. In some jurisdictions, the tariff can list a rate range for intrastate services. TCG may be subject to additional regulatory requirements in some states, such as quality of service requirements, the requirement to offer residential service and make universal service contributions. In New York and New Jersey, TCG has authority to borrow up to $4 billion in long term debt, which is sufficient to amortize all current long term indebtedness of TCG.

including proposals that would either grant ILECs increased pricing flexibility based on increased levels of competition, or mandate lower rates regardless of the level of competition. On May 7, 1997, the FCC issued an Order relating to access charge reform and other matters. The FCC enacted a number of reforms of its switched access rates and adopted rules that will provide discounts to users of certain CLEC switched access transport services, such as those provided by TCG. The first stage of the FCC's reform went into effect on January 1, 1998. Reform of the FCC's access charge rules will result in a significant restructuring of the rates for ILEC interstate switched access services, and a significant increase in pricing flexibility for ILECs. The FCC's access reform decisions have been appealed to the U.S. Court of Appeals for the Eighth Circuit.

Certain of the FCC's access charge reforms are intended to produce a phased transition leading to rates for ILEC tandem switched access services that are closer to the ILECs' costs. Prior FCC policies had required ILECs to price tandem access services below cost, making up the difference by pricing other access services above cost. TCG believes that the new policies will improve TCG's position in competing for the provision of tandem-switched services. Other elements of the FCC's access reforms will lead to lower ILEC rates for certain switched access services, or a restructuring of ILEC switched access rates. These restructured rates could make ILEC exchange access services more attractive to certain high-volume IXCs while reducing the attractiveness of ILEC exchange access services for lower-volume IXCs.

Treatment of Internet Calls. Various ILECs have urged the FCC to require ISPs to pay the same rates that IXCs pay for access to public switched telephone exchanges. Although this position was rejected by the FCC in its May 7, 1997, access charge Order, certain ILECs have also taken the position that they will not pay the reciprocal compensation normally associated with a local call to CLECs with respect to telephone services from the ILEC's customer to an ISP served by a CLEC on the grounds that such calls are exchange access calls rather than local calls. TCG believes these positions are contrary to the 1996 Act and every state commission which has so far considered the issue has declared that ILECs should pay CLECs reciprocal compensation for the Internet traffic. However, no prediction can be made whether the ILECs ultimately will be successful in asserting their positions. If state commissions, the FCC or courts were to reach final decisions which found in favor of the ILECs, such decisions could result in a material adverse effect on TCG, both as an ISP itself and as a provider of TCG local exchange services to other ISPs.

Pay Telephone Compensation. The U.S. Court of Appeals for the District of Columbia decided on July 1, 1997 to reject the system adopted by the FCC for the compensation of providers of pay telephone services by long distance companies. The Court remanded the matter to the FCC for further proceedings. TCG, as a provider of pay telephone services in a number of cities, is a recipient of such pay telephone compensation payments. On October 9, 1997, the FCC adopted new rules which reduce the compensation to providers of pay telephone services.

Universal Service. In its implementation of the 1996 Act, the FCC established new federal universal service mechanisms. Under the new rules, CLECs gain access to universal service subsidies but are required to contribute to both federal and state universal service funds. On December 16, 1997, the FCC approved specific percentage levies for the federal universal service fund ("USF") for the first quarter of 1998. The FCC will initially apply a 0.7 percent levy to gross retail receipts for international, interstate, and intrastate telecommunications to support a new subsidy for schools, libraries, and rural health services; this percentage would gradually rise to about 1.5 percent if subsidy requests rise to maximum funding levels previously approved by the FCC. However, the Congressional Budget Office ("CBO") has estimated that subsidy requests will not approach the funding ceiling until 2008. The CBO predicts that grant applicants will exercise restraint because, in many instances, the federal subsidy will reduce the cost of an advanced telecommunications system by only a small fraction.

Also beginning in 1998, the FCC will apply a 3.2 percent levy to international and interstate telecommunications only to support existing subsidies for rural telephone carriers and low income individuals. The levy rate on interstate and international revenues could rise significantly in 1999 when the USF is expanded to provide support for telephone service to rural areas situated within the territories of larger ILECs. State agreements negotiated prior to enactment of the 1996 Act be submitted to state commissions for approval, and it held that the FCC had no authority to review or enforce agreements approved by state regulators. On rehearing, the Court of Appeals further held that the FCC has no authority to prohibit ILECs from disconnecting unbundled network elements from each other when competitors ask ILECs to refrain from doing so. The Supreme Court has rejected applications to vacate a stay of the FCC's rules pending appeal, but it has agreed to hear arguments on the merits of the case in the fall of 1998.

As indicated above, an FCC rule temporarily precluded IXCs from leasing unbundled switching (and other unbundled network elements) from ILECs for the provision of exchange access only. The effect of this rule lapsed on June 30, 1997. Since that date, IXCs have been free in principle to lease switching and other network elements from ILECs (through IXC-affiliated CLECs) and to use those facilities for exchange access, with or without any local facilities being provided by the IXCs themselves. On August 18, 1997, the FCC issued an order clarifying that CLECs would be permitted to lease access to ILEC switches and interoffice circuits on a per-minute basis. Subsequent court decisions, however, have made it difficult for IXCs to avoid payment of access charges merely by combining unbundled network elements through affiliated CLECs. The July 18, 1997, Court of Appeals Order vacated an FCC rule directing ILECs to recombine unbundled network elements when asked to do so by requesting CLECs. On October 14, 1997, the Eighth Circuit further ruled that CLECs may not direct ILECs to refrain from disconnecting unbundled network elements from each other. As a consequence, CLECs must either combine the elements themselves or purchase entire retail services at the applicable wholesale discounts if they wish to offer local services to their customers. These decisions make it more difficult for IXCs to use affiliated, non-facilities-based CLECs as vehicles for obtaining discounted network elements, and improve the competitive position of facilities-based CLECs like TCG.

ILEC Provision of InterLATA Services. The 1996 Act requires the Bell Operating Companies (Ameritech, Bell Atlantic, BellSouth, SBC Communications and U S WEST) to satisfy certain conditions and obtain FCC approval before they are permitted to provide long distance services in their local telephone service areas. On June 27, 1997, in its first decision on an application by an ILEC for permission to provide long distance services, the FCC found that the ILEC (SBC Communications) had not satisfied the statutory requirements, and it denied SBC's application to offer long distance in Oklahoma. SBC has appealed the denial of its application. The FCC rejected a similar petition by Ameritech for Michigan on August 19, 1997, on the grounds that the technical quality of services that it provides to competitors is inadequate and its systems for receiving and responding to requests for service from competitors requires substantial improvement. Ameritech has appealed the rejection of its petition. On September 30, 1997, BellSouth filed an application with the FCC for permission to provide long distance service in South Carolina. The FCC on December 24, 1997, denied the application, and BellSouth has appealed the FCC's ruling. On November 6, 1997, BellSouth filed an application with the FCC for authority to offer long distance services in Louisiana. On February 4, 1998, the FCC denied BellSouth's application.

On December 31, 1997, a federal judge in Texas held that statutory restrictions on the Bell Operating Companies' ("BOCs") provision of long distance and manufacturing services are an unconstitutional bill of attainder because the restrictions target the BOCs without imposing similar restrictions on other similarly situated companies. The decision has been appealed to a federal court of appeals. If upheld, this ruling could provide BOCs with a basis for arguing that they should immediately be allowed to provide interLATA communications services and engage in manufacturing. However, any provision of long distance service by BOCs would remain subject to review and authorization by state commissions and the FCC, which might impose conditions or requirements that could require or encourage BOCs to open their networks to local competition. Additionally, if the District Court decision is upheld, it is possible that the United States Department of Justice or the U.S. District Court formerly charged with the administration of the Modified Final Judgment might take actions in response thereto.

Access Charge Reform. On December 24, 1996, the FCC adopted certain changes and proposed other changes in the interstate access charge system. The FCC relaxed certain restrictions on ILECs' ability to lower access prices and relaxed the regulation of new switched access services in those markets where there are other providers of access services. The FCC also proposed rules to reform the interstate access charge rate structure, services. TCG has not decided whether to withdraw its FCC tariffs. On the same day, the FCC initiated a further inquiry to determine whether to require that competitive local exchange carriers like TCG withdraw their tariffs. While TCG cannot predict what decision the FCC will reach in this further inquiry, were the FCC to require the withdrawal of TCG's tariffs and replacement of those tariffs with contractual arrangements, TCG could incur substantial legal and administrative expense.

Under the 1996 Act, all local exchange carriers, including TCG, must interconnect with other carriers, make their services available for resale by other carriers, provide non-discriminatory access to rights of way, offer reciprocal compensation for termination of traffic and provide dialing parity and telephone number portability. TCG, ILECs, other CLECs and long distance carriers, will also be required to contribute some portion of their gross revenues (subject to adjustments) to the support of universal service programs under the FCC's rules implementing the universal service provisions of the 1996 Act, which were adopted on May 7, 1997. This order is the subject of appeals pending before the U.S. Court of Appeals for the Fifth Circuit. For the first quarter of 1998, the federal universal service surcharge will be 0.72 percent of all revenues and 3.19 percent of interstate and international revenues for all carriers with interstate revenues. State universal service proceedings are at various stages of implementation, but it is likely that both federal and state contribution requirements will increase substantially in 1999. TCG may also be eligible to receive funds from universal service programs if TCG provides services to schools and libraries. Several parties have sought judicial review of the FCC's universal service rules. In addition, the 1996 Act allows states to adopt universal service rules, so long as they are not inconsistent with the federal program.

Interconnection/Access Arrangements. Under the 1996 Act, ILECs are required to negotiate with TCG to provide for interconnection to the ILEC network. In the event that an interconnection agreement cannot be negotiated the 1996 Act provides for mandatory arbitration before state public utility commissions ("State PUCs"). TCG was able to reach negotiated agreements with NYNEX (now owned by Bell Atlantic) for New York, with Pacific Telesis (now owned by SBC Communications) for California and with BellSouth for its entire region. TCG was required to seek arbitration with ILECs to obtain interconnection agreements in other states where TCG operates. TCG has concluded its initial set of arbitrations and its interconnection agreements are either final or nearing final regulatory approval. However, some ILECs are seeking judicial review of the arbitrated decisions and certain of TCG's final interconnection agreements are subject to appeal to federal and state courts as permitted by the 1996 Act. In particular, TCG's state-arbitrated agreements with U S WEST in Arizona, Colorado, Oregon and Washington State have been appealed by U S WEST. On January 7, 1998, the U.S. District Court in Washington granted TCG's motion and dismissed the U S WEST appeal. The appeals in Arizona, Oregon and Colorado are continuing. TCG's appeal of its Wisconsin arbitration decision was dismissed on October 15, 1997. An additional arbitration appeal brought by SBC Communications is continuing in Texas. In none of these appeals have any preliminary injunctions been sought or granted, and accordingly the interconnection agreements remain valid and in effect in each jurisdiction.

On August 8, 1996, the FCC released both a First Report and Order and a Second Report and Order and a Memorandum Opinion and Order (collectively, the "Interconnection Orders"). The Interconnection Orders established a framework of minimum national standards and procedures to enable State PUCs and the FCC to begin implementing many of the local competition provisions of the 1996 Act. On September 27, 1996, the FCC issued an Order on Reconsideration of the First Report and Order, in which it added a non-usage-sensitive charge to the rate for unbundled switching and clarified that, as a practical matter, an interexchange carrier ("IXC") could not lease unbundled switching for the provision of exchange access service only until July 1, 1997. The new rules were scheduled to become effective on September 30, 1996. On October 15, 1996, however, the U.S. Court of Appeals for the Eighth Circuit issued a stay of certain provisions of the rules pending its resolution of numerous petitions for review filed by ILECs and others. Specifically, the Court stayed the FCC's pricing rules and its "pick and choose" rule, which would have allowed CLECs to receive the benefit of the most favorable provisions contained in an ILEC's agreements with other carriers. On July 18, 1997, the Court of Appeals held that the pricing rules and the "pick and choose" rule exceeded the FCC's authority and were inconsistent with the terms of the 1996 Act. The Court of Appeals also invalidated the FCC's rule requiring that interconnection

City, Missouri/Overland Park, Kansas metropolitan area. The purchase price is approximately $55 million in cash and TCG will be required to assume certain obligations of the seller. Consummation of the purchase of the assets of Kansas City Fiber Network, L.P. is subject to the receipt of required regulatory approvals and other related consents. Accordingly, there can be no assurance that the purchase of the assets of Kansas City Fiber Network, L.P. will be successfully consummated or, if successfully completed, when it might be completed.

TCI Subordinated Note. In December 1997, TCG repaid at a discounted value of approximately $25.1 million the TCI subordinated note (the "TCI Subordinated Note"), in the original principal amount of $26 million, that it had issued to TCI in the TCG Reorganization.

1997 Equity Offering. On November 13, 1997, TCG consummated a public offering of 17,250,000 shares of TCG Class A Common Stock (the "1997 Equity Offering"). Of the 17,250,000 shares, 7,304,408 shares were offered by TCG (realizing net proceeds of approximately $317.4 million to the Company) and 9,945,592 shares were offered by Continental Holding Company, a Massachusetts business trust, the shares of which are owned by Continental, which is wholly owned by U S WEST, Inc. Continental acquired its interest in TCG in May 1993. As a result of the consummation of the 1997 Equity Offering, Continental does not hold any shares of TCG Common Stock.

BizTel Communications, Inc. On October 29, 1997, TCG acquired the remaining 50.1% equity interest in BizTel Communications, Inc. ("BizTel") not owned by TCG in exchange for the issuance of 1,667,631 shares of TCG Class A Common Stock (with cash paid in lieu of any fractional shares). TCG had previously acquired a 49.9% interest in BizTel in February 1996. BizTel holds FCC licenses to provide telecommunications services utilizing 38 GHz digital milliwave transmission in over 200 geographic areas, which include more than 95 of the 100 largest metropolitan markets and all markets where TCG operates. BizTel's 38 GHz milliwave services can be used by TCG to economically connect customers to TCG's fiber optic networks, to provide network redundancy, diverse routing or quick temporary installations and to provide stand-alone facilities where TCG does not have fiber optic networks.

Eastern TeleLogic Corporation. Effective as of March 1, 1997, TCG completed its acquisition of Eastern TeleLogic Corporation ("ETC") for 2,757,083 shares of TCG Class A Common Stock. TCG also assumed $52.6 million in ETC debt and loaned $115 million to ETC, the proceeds of which were used by ETC to redeem the stock held by certain minority shareholders. The acquisition of ETC provides TCG with access to the Philadelphia market, the nation's fifth largest market, and allows TCG to establish a contiguous network between Boston and Washington, D.C. ETC operates a Class 5 digital telephone switch on its 525-mile fiber optic network which connects to more than 360 buildings. After the acquisition, the name of ETC was changed to TCG Delaware Valley, Inc.

CERFnet Services, Inc. On February 4, 1997, TCG acquired from General Atomic Technologies Corporation and General Atomics all the outstanding capital stock of CERFnet Services, Inc. ("CERFnet"), a leading regional provider of Internet-related services to businesses, including dial-up and dedicated Internet access, World Wide Web hosting, and colocation services and Internet training. TCG issued to General Atomics, CERFnet's former controlling stockholder, 2,100,000 shares of TCG Class A Common Stock and granted to General Atomics and certain of its stockholders certain registration rights with respect to such shares. After the acquisition, the name of CERFnet was changed to TCG CERFnet, Inc.

REGULATORY AND GOVERNMENTAL MATTERS

Introduction. TCG is subject to federal and state regulation. In most states, TCG is subject to certification and tariff filing requirements with respect to intrastate services. TCG is permitted to file tariffs for interstate access services with the Federal Communications Commission ("FCC"), although such tariff requirements are generally less onerous than those imposed on ILECs which offer similar services. On June 19, 1997, the FCC adopted an Order that permits CLECs like TCG to voluntarily withdraw their FCC tariffs for most interstate